STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

AQUA ILLINOIS, INC.	:	
	:	Docket No. 10-0194
Proposed increase in general water rates for its Kankakee service area.	:	

REPLY BRIEF OF AQUA ILLINOIS, INC.

Aqua Illinois, Inc. ("Aqua" or "the Company") hereby submits its Reply Brief in accordance with the Administrative Law Judges' established schedule and, in support thereof, states as follows:

I.
EXECUTIVE SUMMARY

The Initial Briefs present the Illinois Commerce Commission ("Commission") with a choice: (1) enter a legally sustainable order based upon analysis contained in testimony and exhibits found in the evidentiary record—as Aqua and Commission Staff ("Staff") urge; or (2) enter an order based upon the untested conjecture of counsel, and information not part of the evidentiary record—which is the position of the Illinois Attorney General's Office ("AG"). The choice is clear: the Commission should follow the law and enter an order based upon the evidentiary record, and reject all of the AG's unfounded claims.

Unlike the positions of Aqua and Staff, the AG's positions are not supported by affirmative testimony and supporting analysis. Rather, the AG improperly cites to information that is not part of the evidentiary record, and concocts claims never presented in testimony, or subject to cross-examination. Not only is this approach inappropriate, it deprives Aqua and Staff the opportunity to respond to the AG's erroneous and unsupported allegations, which have appeared for the first time in briefs. In short, the AG asks the Commission to accept the untested

conjecture of counsel instead of Company and Staff witnesses who have spent the time, and made the effort, to analyze the issues and present that analysis for cross-examination.

In stark contrast, the Company and Staff witnesses conducted substantial analysis, presented testimony and supporting exhibits, all of which are part of the evidentiary record. These witnesses were made available for cross-examination in order to test their analysis and conclusions. The evidentiary record is clear and unambiguous, and demonstrates that a revenue requirement increase of $3,239,493 is just and reasonable. The following explains in detail why the AG's claims should be rejected.

II.
ARGUMENT

The AG's Initial Brief proposes, for the first time, adjustments to Contractual Services – Management Expense, Miscellaneous Expense and the proposed return on equity ("ROE"). Each adjustment should be rejected. To support these adjustments, the AG relies upon information that: (1) this Commission has found should be excluded from the evidentiary record; (2) the AG itself has argued is irrelevant to the Commission's decision in a rate case; (3) is not contained in testimony or evidence found in the evidentiary record; or (4) is misapplied. As described in detail below, each of the AG's claims should be rejected.

A. THE AG'S CITATION TO, AND RELIANCE UPON, PUBLIC COMMENTS IS IMPROPER

The premise of the AG's Initial Brief improperly relies upon, in large part, public comments. AG Init. Br. at 1-2. Illinois law is clear: these public hearing comments are not, nor could they be, part of the evidentiary record in this proceeding; and thus, should not be considered. Indeed, the Commission has confirmed this position in a recent ruling.

Section 10-103 of the Public Utilities Act ("Act") states:

> In all proceedings, investigations or hearings conducted by the Commission, except in the disposition of matters which the Commission is authorized to entertain or dispose of on an ex parte basis, any finding, decision or order made by the Commission **shall be based exclusively on the record** for decision in the case, which shall include only the transcript of testimony and exhibits together with all papers and requests filed in the proceeding, including, in contested cases, the documents and information described in Section 10-35 of the Illinois Administrative Procedure Act.

220 ILCS 5/10-103 (emphasis added). Further, Section 10-35(a) of the Illinois Administrative Procedure Act ("APA") states as follows:

> The record in a contested case shall include the following:
>
> (1) All pleadings (including all notices and responses thereto), motions, and rulings.
> (2) All evidence received.
> (3) A statement of matters officially noticed.
> (4) Any offers of proof, objections, and rulings thereon.
> (5) Any proposed findings and exceptions.
> (6) Any decision, opinion, or report by the administrative law judge.
> (7) All staff memoranda or data submitted to the administrative law judge or members of the agency in connection with their consideration of the case that are inconsistent with Section 10-60 [5 ILCS 100/10-60].
> (8) Any communication prohibited by Section 10-60 [5 ILCS 100/10-60]. No such communication shall form the basis for any finding of fact.

5 ILCS 100/10-35(a). Section 10-35(c) also provides that "[f]indings of fact shall be based **exclusively** on the evidence and on matters officially noticed." 5 ILCS 100/10-35(c) (emphasis added). The Illinois Supreme Court expressly recognized that "[a]ny order of the Commission must 'be based exclusively on the record'." *Business & Professional People for Public Interest v. Illinois Commerce Comm'n*, 136 Ill. 2d 192, 227 (1989) (citing Ill. Rev. Stat. 1987, Ch. 111 2/3, par. 10-103 (now 220 ILCS 5/10-103)).

The law is clear. The finding and conclusions in a Commission Order must be based upon evidence that is contained in the record. Indeed, in a recent Utilities, Inc. rate case, the Commission rejected the AG's attempts to inject untested claims from public hearings for consideration. The Commission recognized that public comments are not part of an evidentiary record.[1] *See* ICC Docket No. 09-0548/09-0549 (Cons.). For these reasons, the Commission should strike the references to such comments in the AG's brief or, alternatively, expressly state that such comments cannot be relied upon when considering this matter.

B. THE AG'S CLAIMS ABOUT UNEMPLOYMENT STATISTICS AND AQUA AMERICA'S EARNINGS ARE NOT RELEVANT TO THE COMMISSION'S EXAMINATION OF AQUA'S COSTS

The AG claims that its proposed adjustments are appropriate because of the unemployment rate in the Kankakee Division service territory, and the earnings experienced by Aqua's parent company, Aqua America. AG Init. Br. at 2-5. The AG's position is legally wrong and factually incorrect. First, the Commission must base its rate determination on the reasonableness of Aqua's costs, not on the regional economy or the earnings of its parent company. 220 ILCS 5/9-201(c); *Business and Professional People for the Public Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 195 (1991).

Not only is the AG's claims about the regional economy legally incorrect, it is contrary to the position the AG recently took in the pending Commonwealth Edison Company ("ComEd") rate case. In that case, the AG argued that the effect of a Commission Order on the regional economy has no place in the record. In a Motion to Strike certain ComEd testimony addressing

[1] Two property owner associations sought to include public comments in their initial brief. Staff filed a motion to strike, which was granted by the Administrative Law Judge. The Commission denied the associations' petition for interlocutory review. In discussing the petition, Chairman Flores stated "the PUA requires us here at the Commission to make our decisions based on the evidentiary record, and that speaks to the need of the people to offer testimony under oath." (Commission minutes, Tr. 13)

how ComEd investment favorably impacts the regional economy, the AG, joined by the Citizens Utility Board and AARP, argued:

> The only conceivable purpose of such testimony is to divert attention from the Commission's required evaluation of the Company's costs and instead suggest that increased rates will benefit the regional economy. This is not a relevant consideration in the Commission's review of the proposed rates and therefore this testimony has no place in the record in this proceeding.

ICC Docket No 10-0467, Mtn to Strike at 3 (filed Aug. 26, 2010). Ironically, that is precisely what the AG's brief is attempting to do in this proceeding: "divert attention from the Commission's required evaluation" of Aqua's costs.

Meanwhile, the earnings of Aqua's parent, Aqua America, have absolutely nothing to do with the Commission's evaluation of the reasonableness of Aqua's test year costs—to claim otherwise is disingenuous. The AG spends several pages discussing Aqua America's financial status, not Aqua's. AG Init. Br. at 3-5. As noted above, Illinois law clearly requires the Commission to base its decision on Aqua's costs, not the financial situation of entities not regulated by the Commission.[2]

The undisputed evidence demonstrates that:

- Aqua has not earned its Commission-authorized rate of return (Walker Sur., Aqua Ex. 9.0, 3:53-55, 21:465-22:473); and
- Aqua will not recover its test year costs under current rates (Blanchette Dir., Aqua Ex. 1.0, 5:17-31).

[2] The AG's reliance on Section 1-102 of the Act is of no consequence. AG Init. Br. at 4. Illinois law clearly provides that the policy statements in the prefatory portion of a statute do not control. *Monarch Gas Co. v. Illinois Commerce Comm'n*, 261 Ill. App. 3d 94, 99 (5th Dist, 1994), citing *Illinois Independent Telephone Assoc. v. Illinois Commerce Comm'n*, 183 Ill. App. 3d 220, 236-37 (1988).

C. AQUA HAS MET ITS BURDEN OF PROOF

Aqua has provided substantial and compelling evidence to support its proposed revenue requirement. Staff agrees, subject to selected adjustments. Aqua/Staff Ex. 1 (the "Stipulation"); Aqua Init. Br., Att. 1 (Errata filed on Oct. 5, 2010). Meanwhile, the AG's claim about the Company's burden of proof is baseless. Moreover, the AG has failed to present any evidence to refute Aqua's and Staff's proposed revenue requirement.

Aqua bears the burden of proof that its proposed rates are just and reasonable. 220 ILCS 5/9-201(c). However, that does not mean that it is the only party that has to prove its claims. Case law is clear:

> In proceedings before the Commission, once a utility makes a showing of the costs necessary to provide service under its proposed charges, it has established a prima facie case. *City of Chicago v. People of Cook County, 133 Ill. App. 3d 435, 478 N.E.2d 1369, 88 Ill. Dec. 643 (1985). The burden then shifts to others* to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith. *City of Chicago v. People of Cook County, 133 Ill. App. 3d 435, 478 N.E.2d 1369, 88 Ill. Dec. 643 (1985).*

Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 327 Ill. App. 3d 768, 776 (3d Dist. 2002) (emphasis added).

Aqua has met its burden. The AG, however, has not. Through its Part 285 filing, sworn testimony and other exhibits admitted into evidence, Aqua provided detailed evidence demonstrating its need for an increase in rates for its Kankakee Division. After investigating and analyzing Aqua's schedules, engaging in discovery, and filing sworn testimony proposing adjustments based upon its investigation, Staff agrees. Aqua/Staff Ex. 1; Aqua Init. Br., Att. 1 (Errata filed on Oct. 5, 2010). In contrast, the AG makes unsubstantiated claims without

providing any testimony in evidence. Rather, the AG attempts to manufacture claims in briefs – there simply is nothing in the evidentiary record to support the AG's "analysis."[3]

Aqua has met its burden to demonstrate that its test year costs are reasonable. Staff agrees, subject to certain adjustments which the Company accepts. Based upon the evidentiary record, it is clear the AG failed to meet its own burden. Consequently, the AG's arguments must be rejected as being without merit.

D. THE EVIDENCE DEMONSTRATES THAT AQUA'S MANAGEMENT FEES ARE REASONABLE

Aqua submitted evidence demonstrating that its Management Fees are reasonable. Staff agreed, subject to a reduction of $75,309. Despite offering no testimony or analysis in the evidentiary record, the AG instead uses a back of the envelop review only found in its brief to propose an additional adjustment of $167,861.[4] The AG's argument is baseless and should be rejected.

The AG makes much of the fact that the Management Fees allocated to the Kankakee Division has increased since its last rate case despite Aqua's total customers in Illinois having decreased by approximately 11,000 customers. AG Init. Br. at 9-11. However, the AG points to no evidence that the costs are unreasonable. Moreover, costs are not allocated in a vacuum. Management costs are allocated from Aqua America to Aqua based on the number of customers in Illinois, as compared to its total number of customers nationwide.[5] These costs are further allocated to the Kankakee Division based the number of its customers as compared to the number of total Aqua customers in Illinois. Other than its own conjecture, the AG has produced

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[3] Because the AG's proposals are made in its initial brief, Aqua and Staff are deprived from responding to the AG claims and testing such claims through cross-examination.

[4]

Aqua Management Fees net of Staff Adjustment	$675,660
AG Proposal per its Initial Brief, p. 11	507,779
Difference	167,861

[5] There is no evidence demonstrating that the customers in Aqua America's non-Illinois jurisdictions increased; thereby making the allocation to Illinois improper.

no evidence that the Management Fees allocated to Illinois and ultimately, the Kankakee Division, is inappropriate.

Aqua witness Paul Hanley testified, there are two reasons why the allocation of Management Fees to the Kankakee Division increased. First, in total, since its last rate case, the number of customers in the Kankakee Division increased by approximately 4,000 customers.[6] Tr. at 64:22-65:3. Second, the total number of customers for Aqua in Illinois decreased. For example, in 2008, Aqua sold its Woodhaven operations (outside of the Kankakee Division), losing approximately 11,600 customers. *Id.* at 58:2-3. Thus, when the Kankakee Division is compared to the rest of Aqua's operation in the State of Illinois, its ratio increased. *Id.* at 58:4-7. As Mr. Hanley explained, the Kankakee Division is being allocated more of the costs because this Division has more customers in relation to the rest of Aqua's operations in the state. *Id.* at 58:8-12.

The AG's claim also ignores the fact that once costs are allocated from Aqua America, they are subject to review. The expenses that come from Aqua America on a monthly basis are reviewed and if not proper, Aqua notifies Aqua America. Tr. at 60:12-16. Also, Aqua tries to do work internally or work with Aqua America in order to lessen external costs, such as from outside auditors and engineers. *Id*. at 17-22. In addition, Aqua provided evidence that its management fees are significantly lower than the management fees associated with other water companies. Tr. at 83:20-84:2.

The AG's reliance on *The Peoples Gas Light and Coke Company v. Slattery* (373 Ill. 31 (1939)) also is misplaced. In *Slattery*, the Commission identified a segment of the New Business Expense related to sales of gas stoves that should be disallowed based upon record evidence.

[6] This includes the two water systems Aqua acquired in 2007—the Village of Manteno and the Village of Sun River Terrace. Tr. at 57:21-58:1.

Slattery, 373 Ill. 31, 65. The program was a rental purchase plan for gas stoves. *Id.* The utility would install the stove on a customer's premises for a trial period (one year). *Id.* After the trial period, the customer would either buy the stove or return it to the utility. *Id.* The record indicated that many stoves were returned, with 50% of the sales price written off as an operating expense. *Id.* The program allowed the utility to engage competition in a non-utility business, but also created an unduly large expenditure for business promotion charged as an operating account. *Id.* Further, the record in that proceeding indicated that the sales were limited to upper-class customers and the stoves replaced existing appliances. *Id.* at 65-66. Thus, the program did not promote the sale of gas, but the sale of stoves. *Id.* at 66. It was in light of these facts in the record that the Court stated:

> We do not think the action of the commission in this respect was unjustified, as, in the very nature of things, a sale of outside articles to promote the sales of a commodity regulated by a utility must be controlled by the commission, as otherwise it would be possible to either raise the operating expenses to unreasonable heights or convert the utility into a mere medium of selling appliances and merchandise not regulated by the commission.

Id. Clearly, the facts at issue in the *Slattery* opinion are inapplicable to the AG's argument. Accordingly, the *Slattery* opinion fails to support the AG's proposed adjustment.

The only evidence in the record demonstrates that the proposed Management Fees for the Kankakee Division, as adjusted by Staff, is just and reasonable and should be approved. The AG's claims are baseless and should be rejected.

E. AQUA'S MISCELLANEOUS EXPENSES ARE PROPER AND SHOULD BE APPROVED

The AG argues that Miscellaneous Expenses should be reduced by $168,653. Again, the AG offers a simplistic analysis that cannot be found in the evidentiary record. Rather, the AG

improperly attempts to present a factual analysis in its brief. AG Init. Br. at12-15. Not only does the AG proposal lack merit, it did not offer any evidence to rebut Aqua's evidence.

The AG's argument boils down to a claim that these costs fluctuate too much. However, there is no evidence that the costs are not reasonable, legitimate costs of Aqua. The Commission is "without authority to arbitrarily reduce an allowance shown to have been actually paid." *Slattery*, 373 Ill. 31 at 61. Where amounts of operating expenses are capable of definite proof, they may not be reduced by estimates of what the expenses should have been "unless there is further showing that, for some reason, the amount was improperly increased over a legitimate cost." *Id.* at 61-62. With its Part 285 filing and sworn testimony, Aqua provided substantial, compelling evidence supporting its Miscellaneous Expenses. Staff analyzed these costs in depth and proposed adjustments to which Aqua does not object.

The AG's adjustment must be rejected as it is without merit. The Commission should approved Aqua's proposed Miscellaneous Expenses as adjusted by Staff.

F. A COST OF COMMON EQUITY OF 10.03% IS SUPPORTED BY THE RECORD AND SHOULD BE APPROVED

Aqua and Staff are the only parties that presented evidence analyzing and proposing a reasonable return on common equity ("ROE") for the Company's Kankakee Division. After considering all of the information in the evidentiary record, Aqua and Staff stipulated to a reasonable ROE of 10.03%. Consequently, AG's claim that the proposed ROE is not based on the record is false. AG Init. Br. at 15.

The AG argues that the Stipulation entered into between Aqua and Staff should be rejected, and that Staff's originally proposed Rate of Return that utilized a ROE of 9.61% should be approved. Other than citing to Staff direct testimony, the AG provides no evidence to support its position. However, the Stipulation adopts Staff's entire rate of return position, with one

exception—that the weighting of Staff's Water Sample Group and Utility Sample Group were adjusted to account for the small sample size. This is supported by Aqua and Staff testimony and results in a reasonable ROE for Aqua.

Aqua's and Staff's rate of return recommendations contained a number of similarities, including: (1) the amount of long-term debt in capital structure; (2) the cost of long-term debt; and (3) the cost of preferred stock. In rebuttal testimony, Aqua agreed to all of Staff's components of rate of return except for the cost of common equity. Walker Reb., Aqua Ex. 6.0 Rev, 33:701-712. The calculation of the Cost of Common Equity remained at issue. In particular, Aqua objected to the size of Staff's Water Sample Group and Utility Sample Group that was the basis of its Cost of Common Equity calculation. Walker Reb., Aqua E. 6.0 Rev., 5:104-12:265; Walker Sur., Aqua Ex. 9.0, 5:8-178. Following the filing of surrebuttal testimony, Aqua and Staff agreed that the cost of common equity estimates for smaller samples are prone to more measurement error. Kight-Garlisch Reb., Staff Ex. 8.0, 5:97-98; Walker Sur., Aqua Ex. 9.0, 7:150 Thus, Aqua and Staff agree to use Staff's proposed ROE analysis, subject to revising the weighting of Staff's Water and Utility Sample Groups to the following: 1/3 weighting to Staff's Water Sample and 2/3 weighting to Staff's Utility Sample. Aqua/Staff Ex. 1.0; Aqua Init. Br., Att. 1 (Errata filed on Oct. 5, 2010). As such, Aqua's cost of common equity should be 10.03%.

The AG states that "The Company and Staff attorneys later stipulated to an increased return on common equity of 10.03%, but did not modify the capital structure or the cost of debt." AG Init. Br. at 16. The AG appears to imply that the Stipulation was agreed to only by Aqua and Staff Counsel, and not Staff. Such an allegation is unfounded and is a disservice not only to

Staff, but Aqua as well. The AG had the opportunity, but declined to cross-examine Staff witness Ms. Kight-Garlisch on this very issue. Tr. at 148:6.

The AG simply has no evidentiary basis to propose an alternate ROE. In contrast, Aqua and Staff have used record evidence, explained the adjustment in weighting through a Stipulation, and have offered its witnesses for cross-examination in support of the Stipulation and their 10.03% ROE conclusion. For these reasons, the Commission should reject the AG's ROE proposal.

VII.
CONCLUSION

Aqua Illinois, Inc. respectfully requests that the Commission reject the untested and unsubstantiated non-record claims of the Illinois Attorney General's Office. Instead, the Commission should approve the Company's and Staff's proposed revenue requirement and related tariffs for its Kankakee Water Division, which are based on information and analysis set forth in the evidentiary record.

Dated: October 7, 2010

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, John E. Rooney, hereby certify that I caused a copy of the Reply Brief of Aqua Illinois, Inc. to be served upon the service list in Docket No. 10-0194 by email on October 7, 2010.

/s/ John E. Rooney
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